

CHEBOYGAN COUNTY ROAD COMMISSION
A Component Unit of Cheboygan County, Michigan

ANNUAL FINANCIAL REPORT
with Supplementary Information

FOR THE YEAR ENDED DECEMBER 31, 2012

CHEBOYGAN COUNTY ROAD COMMISSION
A Component Unit of Cheboygan County, Michigan

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INDEPENDENT AUDITOR'S REPORT

To the Board of County Road Commissioners
of Cheboygan County
Indian River, Michigan

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, the General Fund, and the Employee Health Care Benefit Trust Fund of the Cheboygan County Road Commission (the "Road Commission"), a component unit of Cheboygan County, Michigan as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the Road Commission's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Road Commission's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Road Commission's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the General Fund, and the Employee Health Care Benefit Trust Fund of the Cheboygan County Road Commission as of December 31, 2012, and the respective changes in financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 3-6 and page 28 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

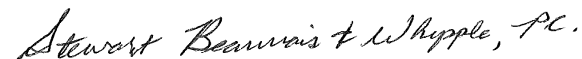
Supplementary Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Road Commission's basic financial statements. The accompanying supplementary information as listed in the table of contents and presented on pages 29-31 is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated April 15, 2013 on our consideration of the Road Commission's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Road Commission's internal control over financial reporting and compliance.


Certified Public Accountants

April 15, 2013

MANAGEMENT’S DISCUSSION AND ANALYSIS

As management of the Cheboygan County Road Commission (the “Road Commission”), we offer readers of these financial statements this narrative, overview and analysis of the financial activities of the Road Commission for the year ended December 31, 2012. This discussion and analysis is designed to assist the reader in focusing on the significant financial issues and activities and to identify any significant changes in financial position.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to provide a basis of understanding of the Road Commission’s basic financial statements. These basic financial statements comprise three components: (1) government-wide financial statements, (2) general and fiduciary fund financial statements, and (3) notes to the financial statements. Supplementary financial information is also provided for additional information purposes.

Government-wide Financial Statements

The government-wide financial statements are designed to provide readers with a broad overview of the Road Commission’s finances, in a manner similar to a private-sector business.

The *statement of net position* presents information on all of the Road Commission’s assets and liabilities, with the differences between the two reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the Road Commission is improving or deteriorating.

The *statement of activities* presents information showing how the government’s net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods.

General Fund Financial Statements

Unlike the government-wide financial statements, General Fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the year. Such information may be useful in evaluating a government’s near-term financing requirements.

Because the focus of the General Fund financial statements are narrower than that of the government-wide financial statements, it is useful to compare the information presented for General Fund financial statements with similar information presented for government-wide financial statements. By doing so, readers may better understand the long-term impact of the government’s near term financing decisions.

Both the General Fund balance sheet/Governmental activities statement of net position and the General Fund statement of revenues, expenditures, and changes in fund balance/Governmental activities statement of activities provide a reconciliation to facilitate this comparison between the General Fund financial statements and the government-wide financial statements.

The Road Commission adopts an annual appropriated budget for the General Fund. A budgetary comparison statement has been provided to demonstrate compliance with this budget.

Fiduciary Fund Financial Statements

The Employee Health Care Benefit Trust Fund (fiduciary fund) is used to account for resources held in trust for members and beneficiaries of the Road Commission's retirees health care plan. The fiduciary fund activity is not reflected in the government-wide financial statements because the resources are not available to support the Road Commission's own programs. The Road Commission's Employee Health Care Benefit Trust Fund is reported in the statements of fiduciary net position and changes in fiduciary net position. The accounting used for fiduciary funds is much like that used for the government-wide presentation. The Road Commission is responsible for ensuring that the assets reported in this fund are used for its intended purpose.

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and general and fiduciary fund financial statements. The notes to the financial statements can be found on pages 10-27 of this report.

FINANCIAL HIGHLIGHTS

Government-wide Financial Analysis

As noted earlier, net position may serve over time as a useful indicator of a government's financial position. As shown on the chart below, the Road Commission's assets exceeded liabilities by \$27,908,611 at December 31, 2012.

Net position is separated into two major components, net investment in capital assets of \$26,405,536 or 94.6% of net position and unrestricted net position of \$1,503,075 or 5.4%. The net investment in capital assets of the Road Commission reflects its investment in capital assets (i.e. land, buildings, vehicles, equipment and infrastructure), less any related debt used to acquire those assets that is still outstanding. The Road Commission uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the Road Commission's net investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. The remaining balance of unrestricted net position may be used to meet the Road Commission's ongoing obligations to citizens and creditors.

At the end of the current year, the Road Commission is able to report positive balances in both categories (net investment in capital assets and unrestricted) of net position. The Road Commission's combined net position increased \$1,072,389 from a year ago.

The following table presents a comparison of the Statement of Net Position at December 31, 2012 and 2011 in a condensed format:

| Condensed Statement of Net Position | 2012 | 2011 |
|--|----------------------|----------------------|
| Assets - | | |
| Current and other unrestricted assets | \$ 3,455,321 | \$ 3,060,056 |
| Capital Assets | <u>28,780,536</u> | <u>28,088,833</u> |
| Total Assets | <u>32,235,857</u> | <u>31,148,889</u> |
| Liabilities - | | |
| Long-term liabilities | 3,927,109 | 3,893,495 |
| Other liabilities | <u>400,137</u> | <u>419,172</u> |
| Total Liabilities | <u>4,327,246</u> | <u>4,312,667</u> |
| Net Position - | | |
| Net investment in capital assets | 26,405,536 | 25,618,833 |
| Unrestricted | <u>1,503,075</u> | <u>1,217,389</u> |
| Total Net Position | <u>\$ 27,908,611</u> | <u>\$ 26,836,222</u> |

The following table presents a comparison of the Statement of Activities for the year ended December 31, 2012 and 2011 in a condensed format:

| Condensed Statement of Activities | <u>2012</u> | <u>2011</u> |
|--|---------------------|-------------------|
| Revenues | | |
| Federal Sources | \$ 28,079 | \$ 575,601 |
| State Sources | 4,800,685 | 4,005,014 |
| Local Sources | 708,799 | 965,274 |
| Charges for Services and Other | <u>2,167,542</u> | <u>1,587,731</u> |
| | <u>7,705,105</u> | <u>7,133,620</u> |
| Expenses | | |
| Maintenance | 4,546,306 | 4,228,720 |
| Administrative | 431,583 | 362,717 |
| Equipment (net) | 230,955 | 256,264 |
| Depreciation | 1,314,782 | 1,314,960 |
| Other - Debt Interest | <u>109,090</u> | <u>113,322</u> |
| | <u>6,632,716</u> | <u>6,275,983</u> |
| Change in Net Position | <u>\$ 1,072,389</u> | <u>\$ 857,637</u> |

General Fund Financial Analysis

As noted earlier, the focus of the General Fund financial statements is to provide information on the near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the Road Commission's financing requirements. In particular, unassigned fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current year, the Road Commission reported an ending fund balance of \$3,035,748, an increase of \$416,534 from the prior year. Approximately 68%, or \$2,056,644, of the fund balance constitutes unassigned fund balance, which is available for spending at the Road Commission's discretion. The remainder of the fund balance in the amount of \$979,104 is nonspendable for prepaid items and inventory.

BUDGETARY HIGHLIGHTS

The Road Commission amended its 2012 budget mainly to reflect bond refinancing that was pushed to future years. The final budget was within 4.7% of the original budget for revenues and (2.3%) for expenditures. Actual 2012 revenues were \$353,987 greater than the final budget mainly as a result of MDOT audit adjustments for 2010 and 2011 that totaled \$322,077 in additional revenues that were not budgeted for. Actual expenditures were within (2.6%) of final budget.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets - The Road Commission had \$28,780,536 in capital assets at the end of the year, representing an increase of \$691,703 or 2.46% from the previous year. A summary of capital assets net of accumulated depreciation at December 31, 2012 in comparison to the previous year is as follows:

| | <u>2012</u> | <u>2011</u> |
|--------------------------------------|----------------------|----------------------|
| Land, Improvements and Right-of-Ways | \$ 10,719,559 | \$ 10,554,689 |
| Buildings and Improvements | 2,082,504 | 2,259,026 |
| Equipment | 372,348 | 351,754 |
| Depletable Assets | 11,753 | 11,753 |
| Infrastructure | <u>15,594,372</u> | <u>14,911,611</u> |
| Total Capital Assets | <u>\$ 28,780,536</u> | <u>\$ 28,088,833</u> |

Additional information on the Road Commission's capital assets may be found in Note 7 to the financial statements.

Long-Term Liabilities - At the end of the current year, the Road Commission had total bond debt principal requirements of \$2,375,000. The bond debt is backed by the full faith and credit of Cheboygan County. The total debt was issued in anticipation of and payable from State collected taxes returned to the Road Commission from the Michigan Transportation Fund for highway construction and work incidental thereto. A summary of the Long-Term Debt is as follows:

| | <u>2012</u> | <u>2011</u> |
|---|---------------------|---------------------|
| Michigan Transportation Bonds – Series 2004 | <u>\$ 2,375,000</u> | <u>\$ 2,470,000</u> |

The Road Commission also had other long-term liabilities for accrued vacation and sick of \$396,303 and a net OPEB obligation of \$1,155,806 at December 31, 2012.

Additional information on the Road Commission's long-term liabilities may be found in Note 9 to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

2013 projections are that State Motor Vehicle revenues are expected to again decrease from 2012 levels. Revenues for Federal STP are projected at \$180,000 in the form of safety grants. Activities for 2013 will be primarily geared towards maintenance. Construction and improvements to the local road system will be completed with the help of non-Road Commission, typically Township revenue sources. Capital outlay purchases continue languish due to anticipated decreased funding levels. Improvements and/or construction on the primary system are not anticipated before 2014. Preventative maintenance on the primary system has been non-existent and is expected to remain so without some increase in statewide transportation funding or a successful local millage campaign.

CONTACTING THE ROAD COMMISSION MANAGEMENT

This financial report is designed to provide a general overview of the Cheboygan County Road Commission's finances and to show accountability. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Cheboygan County Road Commission, 5302 South Straits Hwy, Indian River, Michigan, 49749.

BASIC FINANCIAL STATEMENTS

CHEBOYGAN COUNTY ROAD COMMISSION
A Component Unit of Cheboygan County, Michigan

GENERAL FUND BALANCE SHEET
GOVERNMENTAL ACTIVITIES STATEMENT OF NET POSITION
DECEMBER 31, 2012

| | General Fund | Adjustments (Note 2) | Governmental Activities |
|---|---------------------|-------------------------|----------------------------|
| ASSETS | | | |
| Cash and cash equivalents | \$ 1,414,034 | \$ - | \$ 1,414,034 |
| Due from other governmental units - | | | |
| State | 965,081 | - | 965,081 |
| Local | 15,058 | - | 15,058 |
| Accounts receivable | 18,827 | - | 18,827 |
| Prepaid items | 119,297 | - | 119,297 |
| Deposits - health insurance | 26,191 | - | 26,191 |
| Deferred charges - Bond issuance costs | - | 63,217 | 63,217 |
| Inventory | 833,616 | - | 833,616 |
| Capital assets, net of accumulated depreciation | | | |
| Assets not being depreciated | - | 10,719,559 | 10,719,559 |
| Assets being depreciated - net | - | 18,060,977 | 18,060,977 |
| | <u>\$ 3,392,104</u> | <u>\$ 28,843,753</u> | <u>\$ 32,235,857</u> |
| LIABILITIES AND FUND EQUITY | | | |
| Liabilities: | | | |
| Accounts payable | \$ 100,688 | \$ - | \$ 100,688 |
| Accrued liabilities | 81,529 | - | 81,529 |
| Accrued interest payable | - | 43,781 | 43,781 |
| Due to other governmental units | 35 | - | 35 |
| Advances and deposits | 174,104 | - | 174,104 |
| Non-Current Liabilities - | | | |
| Due within one year | - | 202,266 | 202,266 |
| Due in more than one year | - | 2,275,000 | 2,275,000 |
| Accrued vacation and sick | - | 294,037 | 294,037 |
| Net OPEB obligation | - | 1,155,806 | 1,155,806 |
| Total Liabilities | <u>356,356</u> | <u>3,970,890</u> | <u>4,327,246</u> |
| Fund Balance: | | | |
| Nonspendable - | | | |
| Prepays and deposits | 145,488 | (145,488) | - |
| Inventory | 833,616 | (833,616) | - |
| Unassigned | 2,056,644 | (2,056,644) | - |
| Total Fund Balance | <u>3,035,748</u> | <u>(3,035,748)</u> | <u>-</u> |
| Total Liabilities and Fund Balance | <u>\$ 3,392,104</u> | | |
| Net Position: | | | |
| Net investment in capital assets | | 26,405,536 | 26,405,536 |
| Unrestricted | | 1,503,075 | 1,503,075 |
| Total Net Position | | <u>\$ 27,908,611</u> | <u>\$ 27,908,611</u> |

The accompanying notes are an integral part of these financial statements.

CHEBOYGAN COUNTY ROAD COMMISSION
A Component Unit of Cheboygan County, Michigan

**STATEMENT OF GENERAL FUND REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE/GOVERNMENTAL ACTIVITIES STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 2012**

| | General Fund | Adjustments (Note 2) | Governmental Activities |
|--|----------------------------|-----------------------------|-----------------------------|
| Revenues: | | | |
| Permits | \$ 29,005 | \$ - | \$ 29,005 |
| Intergovernmental - | | | |
| Federal sources | 28,079 | - | 28,079 |
| State sources | 4,800,685 | - | 4,800,685 |
| Local sources | 708,799 | - | 708,799 |
| Charges for services | 2,092,971 | - | 2,092,971 |
| Interest and rents | 1,722 | - | 1,722 |
| Other | 43,844 | - | 43,844 |
| Total Revenues | <u>7,705,105</u> | <u>-</u> | <u>7,705,105</u> |
| Expenditures/Expenses: | | | |
| Current - | | | |
| Primary preservation - structural improvements | 1,264,371 | (1,264,371) | - |
| Local preservation - structural improvements | 576,132 | (576,132) | - |
| Primary maintenance | 1,058,791 | 11,141 | 1,069,932 |
| Local maintenance | 1,705,637 | 34,055 | 1,739,692 |
| State maintenance | 1,736,682 | - | 1,736,682 |
| Administrative | 396,747 | 34,836 | 431,583 |
| Equipment operations - | 2,254,400 | (251,044) | 2,003,356 |
| Less equipment rental | | | |
| charged to other activities | (1,772,401) | - | (1,772,401) |
| Depreciation | - | 1,314,782 | 1,314,782 |
| Capital Outlay | 167,027 | (167,027) | - |
| Less: depreciation credit | | | |
| and retirements | (300,671) | 300,671 | - |
| Debt Service - | | | |
| Principal | 95,000 | (95,000) | - |
| Interest | 106,856 | 2,234 | 109,090 |
| Total Expenditures/Expenses | <u>7,288,571</u> | <u>(655,855)</u> | <u>6,632,716</u> |
| Change in Fund Balance/Net Position | 416,534 | 655,855 | 1,072,389 |
| Fund Balance/Net Position at January 1, 2012 | <u>2,619,214</u> | <u>24,217,008</u> | <u>26,836,222</u> |
| Fund Balance/Net Position at December 31, 2012 | <u><u>\$ 3,035,748</u></u> | <u><u>\$ 24,872,863</u></u> | <u><u>\$ 27,908,611</u></u> |

The accompanying notes are an integral part of these financial statements.

CHEBOYGAN COUNTY ROAD COMMISSION

STATEMENT OF FIDUCIARY NET POSITION

EMPLOYEE HEALTH CARE BENEFIT TRUST FUND

DECEMBER 31, 2012

ASSETS:

| | |
|--|------------|
| Investments, at fair value - Mutual Funds | \$ 110,204 |
|--|------------|

| | |
|---|-------------------|
| NET POSITION - RESTRICTED FOR OPEB | \$ 110,204 |
|---|-------------------|

STATEMENT OF CHANGES IN FIDUCIARY NET POSITION

EMPLOYEE HEALTH CARE BENEFIT TRUST FUND

FOR THE YEAR ENDED DECEMBER 31, 2012

Additions:

| | |
|---|-----------|
| Employer contributions | \$ 50,000 |
| Investment income - Net appreciation (depreciation) in fair value of investments | 8,908 |
| Total Additions | 58,908 |

Deductions:

| | |
|--------------------------|-----|
| Investment advisory fees | 371 |
|--------------------------|-----|

| | |
|--------------|--------|
| Net increase | 58,537 |
|--------------|--------|

Net Position - Restricted for OPEB:

| | |
|-------------------|------------|
| Beginning of year | 51,667 |
| End of year | \$ 110,204 |

The accompanying notes are an integral part of these financial statements.

CHEBOYGAN COUNTY ROAD COMMISSION
A Component Unit of Cheboygan County, Michigan

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The financial statements of the Cheboygan County Road Commission (the "Road Commission"), a component unit of Cheboygan County, Michigan have been prepared in conformity with accounting principles generally accepted in the United States of America as applied to governmental entities, including the following accounting policies specific to road commissions: allocation of depreciation/depletion and equipment rental, the recording of handling and overhead credits and the recording of equipment retirements with the related gain or loss on disposal of equipment. The more significant accounting policies are described as follows:

A. Description of Road Commission Operations -

The Road Commission is a component unit of the County of Cheboygan, Michigan, and is used to control the expenditure of revenues from the State distribution of gas and weight taxes, federal financial assistance, reimbursements from the Department of State Highways for work performed by the County on State trunklines and contributions from other local units of government (township) for work performed by the Road Commission. The General Fund is the operating fund of the Road Commission.

The Road Commission, which is established pursuant to the County Road Law (MCL224.1), operates under an elected Board of five (5) County Road Commissioners who establish policies and review operations of the Road Commission. The Road Commission provides service to nineteen (19) Townships in Cheboygan County and maintains over 1,440 miles of state, local and primary roads.

B. Government-wide and Fund Financial Statements -

The government-wide financial statements (i.e. the statement of net position and the statement of activities) report information on the nonfiduciary activities of the Road Commission.

Separate financial statements are provided for the General Fund and the Employee Health Care Benefit Trust Fund, even though the latter is excluded from the government-wide financial statements.

C. Measurement Focus, Basis of Accounting and Financial Statement Presentation -

The government-wide financial statement columns (i.e., statement of net position and statement of activities) are reported using the economic resource measurement focus and the accrual basis of accounting, as are the fiduciary fund financial statements. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grant and similar items are recognized as revenues as soon as all eligibility requirements imposed by the provider have been met.

CHEBOYGAN COUNTY ROAD COMMISSION
A Component Unit of Cheboygan County, Michigan

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (cont'd):

The General Fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenue is recognized when it is both measurable and available. Revenue is considered to be available if it is collected within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within 60 days of the end of the year. The major revenues susceptible to accrual are motor vehicle highway funds and township contributions. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, expenditures relating to compensated absences, and claims and judgments are recorded only when payment is due.

The Road Commission reports the following fund types -

Governmental Fund Type -

The General Fund is the Road Commission's primary operating fund. It accounts for all financial resources of the Road Commission, not accounted for and reported in another fund.

Fiduciary Fund Type -

The Employee Health Care Benefit Trust Fund is used to account for the accumulation and investment of funds to provide for the funding of health care benefits for retirees of the Road Commission.

D. Assets, Liabilities, and Fund Balance or Net Position -

Cash and Cash Equivalents - The Road Commission's cash consists of cash on hand, demand deposits and savings deposits. Cash equivalents are short-term investments that are readily convertible to cash or have a maturity date of 90 days or less from the date of purchase and approximate fair value.

Investments - The Road Commission's investments are in mutual funds which are stated at fair value.

Inventories - Inventories of road materials and equipment parts are recognized using the consumption method (inventories are recorded as expenditures when they are used). Inventories are stated at average cost, which approximates market.

Prepaid Items - Certain payments to vendors (particularly for insurance coverage) reflect costs that are applicable to future accounting periods and are recorded as prepaid items in the General Fund and government-wide basic statements.

CHEBOYGAN COUNTY ROAD COMMISSION
A Component Unit of Cheboygan County, Michigan

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (cont'd):

Capital Assets - Capital assets, which include property, plant, equipment, and infrastructure, are reported in the government-wide (statement of net position) financial statements. Capital assets for land, buildings and improvements and all equipment except road equipment are defined by the Road Commission as assets with estimated useful lives in excess of a year. Road equipment is capitalized as defined by the Michigan Department of Transportation without consideration of minimum cost. Capital assets and infrastructure are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized. Capital asset acquisitions are recorded in the General Fund (statement of revenues, expenditures and changes in fund balances) financial statements as capital outlay expenditures at the time of purchase.

Depreciation is computed on the sum-of-the-years digits method for road equipment and the straight-line method for all other fixed assets over the estimated useful life of the related asset.

The estimated useful lives are as follows:

| | |
|----------------------------|-------------|
| Buildings and Improvements | 40 years |
| Equipment | 5- 8 years |
| Roads | 8-20 years |
| Bridges | 25-50 years |

Infrastructure is reported retrospectively from 1980, except for right-of-ways and bridges, which are required to be reported despite the date of purchase. Roads are removed from the capital assets at the time the group of individually recorded roads has been fully depreciated.

Depletion is calculated as the amount of prorated cost or other indicated value assigned to the extracted portion of a natural resource.

The Uniform Accounting Procedures Manual for Michigan County Road Commissions (the "Manual") provides for recording depreciation and depletion in the governmental fund statements as a charge to various expenditure accounts, and a credit to a depreciation/depletion credit account. Accordingly, the annual depreciation/depletion expenditures do not affect the available operating equity (fund balance) of the General Fund financial statements.

The Manual also provides for the net book value of road equipment that is retired to be reported as an equipment retirement in an equipment retirement credit account that is offset against capital outlay. The net of any proceeds received for the retirement (sale, abandonment, or trade-in) is reported as a gain or loss on disposal of equipment. As a result, fund balance of the General Fund is not affected.

Deferred/Unearned Revenues - In both the government-wide and the General Fund financial statements, revenue received or recorded before earned is recorded as unearned revenue. In the General Fund financial statements, revenues that have not met the availability criteria for revenue recognition are recorded as deferred revenues.

CHEBOYGAN COUNTY ROAD COMMISSION
A Component Unit of Cheboygan County, Michigan

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (cont'd):

Accrued Vacation And Sick - In accordance with contracts negotiated with the various employee groups of the Road Commission, individual employees have a vested right upon termination of employment to receive payments for unused sick leave and vacation under formulas and conditions specified in the contracts. All amounts vested are accrued in the government-wide statements (statement of net position).

Advances From The State Of Michigan - The State of Michigan advances funds on a State maintenance agreement it has with the Road Commission for specified maintenance, which the Road Commission will perform during the year, and for equipment purchases. These advances are considered current liabilities because they are subject to repayment annually upon audit by the State of Michigan.

Equipment Rental - The Manual provides that the cost of operating equipment, including depreciation, be charged (allocated) to the various activities. The credit of this allocation is an offset to equipment expenditures/expenses. As a result, the available fund equity is not affected.

Handling and Overhead Credits - The Manual provides that the charging of handling and overhead based on a calculation related to a specific project's cost, particularly the State Trunkline agreements, be reported as an expenditure/expense under the appropriate activity and a credit to a handling or overhead credit account that is offset against the Administrative activity. As a result, the available operating fund equity is not affected.

Long-Term Obligations - In the government-wide financial statements (statement of net position), long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt. As permitted by GASB Statement No. 34, the Road Commission has elected to not apply the provisions related to bond premiums discounts, and issuance costs on a prospective basis.

Fund Balance - In the financial statements the General Fund reported a fund balance in one or more of the following classifications:

Nonspendable fund balance - the portion of fund balance that cannot be spent because of its form or because it must be maintained intact.

Restricted fund balance - the portion of fund balance that has limitations imposed on use by external sources.

Committed fund balance - amounts that can only be used for specific purposes pursuant to constraints imposed by formal action via board resolution (e.g., to establish, modify or rescind), of the highest level of decision-making authority (Board of County Road Commissioners).

CHEBOYGAN COUNTY ROAD COMMISSION
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NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (cont'd):

Assigned fund balance - the portion of fund balance that reflects the Road Commission's intended use of resources. Such intent currently must be determined by the Managing Director or designee as provided via resolution of the Board of County Road Commissioners.

Unassigned fund balance - the portion of a fund balance in the General Fund that cannot be classified into one of the four categories above.

When different classifications of fund balance are present, it is the Road Commission's policy that expenditures are to be spent from restricted fund balance first, if appropriate, followed in order by committed fund balance, then assigned and lastly unassigned.

Pension and Other Postemployment Benefits (OPEB) - The Road Commission offers both pension and retiree healthcare benefits to employees. The Road Commission receives an actuarial valuation for pension and an alternative measurement method calculation permitted by GASB 45 for OPEB to compute the annual required contribution (ARC) necessary to fund the obligations over the remaining amortization period. In the General Fund, pension and OPEB cost recognition occurs as contributions are made. For the government-wide statements, the Road Commission reports the full accrual cost equal to the current year required contribution, adjusted for interest, and "adjustment to the ARC" on the beginning of year underpaid amount, if any.

Estimates - In preparing financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Upcoming Accounting Pronouncements - Recently the Governmental Accounting Standards Board (GASB) issued the following statements that will have an impact on the Road Commission's financial statement when adopted. The Road Commission is currently evaluating the implications of each of the pronouncements.

GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities* was issued in March 2012 and is effective for the Road Commission's December 31, 2013 fiscal year. The statement provides additional guidance to GASB 63, establishing the accounting and financial reporting standard that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities.

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NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (cont'd):

GASB Statement No. 68, *Accounting and Financial Reporting for Pensions* was issued in June 2012 and will become effective for the Road Commission's December 31, 2015 fiscal year. The statement requires governments providing defined benefit plans to report the net pension liability in their statement of net position. The net pension liability is the difference between the total pension liability (the present value of projected benefit payments to employees based on their past service) and the assets (mostly investments reported at fair value) set aside in a trust and restricted to paying benefits to current employees, retirees, and their beneficiaries. The statement also will improve the comparability and consistency of how governments calculate the pension liabilities and expenses.

NOTE 2 - RECONCILIATION OF GOVERNMENT-WIDE AND GENERAL FUND FINANCIAL STATEMENTS:

A. Explanation of differences between the General Fund balance sheet and the Governmental Activities Statement of Net Position (Page 7).

| | |
|--|----------------------|
| Fund Balance - General Fund | \$ 3,035,748 |
| Capital assets used in the General Fund activities that are not financial resources and therefore not reported in the General Fund financial statements | |
| Add - capital assets | 48,033,112 |
| Deduct - accumulated depreciation | (19,252,576) |
| Long-term liabilities that are not due in the current period therefore not reported in the General Fund financial statements | |
| Bonds Payable | (2,375,000) |
| Net OPEB Obligation | (1,155,806) |
| Accrued Compensated absences | (396,303) |
| Accrued interest payable on long-term liabilities not reported in the General Fund financial statements | (43,781) |
| Bond Issuance costs reported as debt retirement in the General Fund financial statements but deferred and amortized from net position in the Statement of Net Position | <u>63,217</u> |
| Net Position - Governmental Activities | <u>\$ 27,908,611</u> |

CHEBOYGAN COUNTY ROAD COMMISSION
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NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

NOTE 2 - RECONCILIATION OF GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS - (cont'd):

- B.** Explanation of differences between the Statement of General Fund Revenues, Expenditures, and Change in Fund Balance and the Governmental Activities Statement of Activities (Page 8).

| | |
|---|---------------------|
| Change in fund balance - | |
| General Fund financial statements | \$ 416,534 |
| The General Fund financial statements report capital outlay as expenditures, however, in the government-wide Statement of Activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense | |
| Add - capital outlay and infrastructure | 2,007,530 |
| Deduct - depreciation | (1,314,782) |
| Deduct - retirements | (1,045) |
| Interest expense adjustment for accrual reported in the government-wide Statement of Activities when the liability is incurred and reported in the General Fund financial statements only when payment is due | 1,485 |
| Principal payments on long-term liabilities are reported as an expenditure in the General Fund financial statements, but not in the government-wide Statement of Activities where it reduces the long-term liability | 95,000 |
| Amortization of issuance costs expensed in the General Fund financial statements in the initial year, but deferred and amortized in the Statement of Activities | (3,719) |
| Some expenses reported in the government-wide Statement of Activities do not require the use of current financial resources, and therefore are not reported as expenditures in the General Fund financial statements - | |
| Decrease in accrued sick and vacation | 27,569 |
| Increase in other postemployment benefits | (156,183) |
| Change in Net Position - Governmental Activities | \$ <u>1,072,389</u> |

CHEBOYGAN COUNTY ROAD COMMISSION
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NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

NOTE 3 - STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY:

Budgetary Compliance -

The Road Commission Manager prepares from data submitted by the administrative staff, a proposed operating budget for the calendar year commencing January 1. The operating budget includes proposed expenditures and resources to finance them.

The budget for the General Fund is adopted on the modified accrual basis, which is consistent with accounting principles generally accepted in the United States of America.

Prior to December 31, the proposed budget is presented to the Board of County Road Commissioners. The Board holds a public hearing and may add to, subtract from or change appropriations. The budget is then legally enacted through passage of a Board of County Road Commissioner's resolution.

The Road Commission's approved budget was adopted at the activity level. This is the legally enacted level under the State of Michigan Uniform Budgeting and Accounting Act since amendments to the budget at the activity level must be approved by the Board of County Road Commissioners.

The Road Commission does not employ encumbrance accounting as an extension of formal budgetary integration. All annual appropriations lapse at year-end.

Michigan Public Act 621 of 1978, Section 18(1) as amended, provides that a governmental unit shall not incur expenditures in excess of the amount appropriated at the legally adopted level.

Excess of Expenditures Over Appropriations -

| | <u>Appropriations</u> | <u>Expended</u> | <u>Variance</u> |
|----------------------|-----------------------|-----------------|-----------------|
| State maintenance | \$ 1,669,600 | \$ 1,736,682 | \$(67,082) |
| Equipment – net | 107,000 | 481,999 | (374,999) |
| Capital Outlay – net | (162,433) | (133,644) | (28,789) |

NOTE 4 - DEPOSITS AND INVESTMENTS:

As of December 31, 2012, the carrying amount of deposits and investments is as follows:

| | <u>General Fund</u> | <u>Fiduciary Fund</u> | <u>Reporting Entity</u> |
|--------------------------------|-------------------------|---------------------------|-----------------------------|
| Cash and Cash Equivalents - | | | |
| Petty Cash | \$ 300 | \$ - | \$ 300 |
| Maintained by County Treasurer | 1,413,734 | - | 1,413,734 |
| Investments - | | | |
| Mutual Funds | <u>-</u> | <u>110,204</u> | <u>110,204</u> |
| | <u>\$ 1,414,034</u> | <u>\$ 110,204</u> | <u>\$ 1,524,238</u> |

CHEBOYGAN COUNTY ROAD COMMISSION
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NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

NOTE 4 - DEPOSITS AND INVESTMENTS - (cont'd):

The Manual provides that the County Treasurer maintain the cash of the Road Commission. All Road Commission receipts are deposited with the Cheboygan County Treasurer's Office, and in order to make disbursements, the Cheboygan County Road Commission requests the County Treasurer to transfer the required funds to an imprest vendor or payroll checking account. The investing of cash is performed by the County Treasurer.

Custodial Credit Risk - Deposits - is the risk that in the event of a bank failure, the Road Commission's deposits may not be returned to it. Michigan Public Acts authorize Road Commissions to deposit into the accounts of federally insured banks, insured credit unions, and savings and loan associations with an office in Michigan. The Road Commission's investment policy does not have a custodial credit risk requirement.

The Road Commission's deposits consist of demand accounts and savings accounts. At December 31, 2012, the carrying amount of the Road Commission's deposits is \$1,413,734, and the bank balance is \$1,497,260. As a component unit of Cheboygan County, all Road Commission cash is part of the accounts maintained by Cheboygan County, at financial institutions insured by federal deposit insurance. However, it cannot be determined to what extent the insurance applies to the Road Commission.

Investments -

General Fund:

The Road Commission's investment policy allows it to invest in funds authorized by Michigan Public Act 20 of 1994. Michigan Public Act 20 of 1994, as amended, authorizes Road Commissions to invest surplus funds in bonds, securities and other direct obligations of the United States government or an agency or instrumentality of the United States; certificates of deposit, savings accounts, deposit accounts or depository receipts of a financial institution only if the bank, savings and loan association or credit union is eligible to be a depository of funds belonging to the state; bankers' acceptances of the United States banks; commercial paper rated at the time of purchase within the highest classification established by not less than two standard rating services, which mature not more than 270 days after the date of purchase; bankers' acceptance notes, obligations of the State of Michigan or any of its political subdivisions that at the time of purchase are rated as investment grade by not less than 1 standard rating service; mutual funds registered under the Investment Company Act of 1940, with the authority to purchase only investment vehicles that are legal for direct investment by a public corporation; investment pools through an interlocal agreement under the Urban Cooperation Act of 1967; and investment pools organized under the Surplus Funds Investment Pool Act, 1982 PA 3657, 129.111 to 129.118.

CHEBOYGAN COUNTY ROAD COMMISSION
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NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

NOTE 4 - DEPOSITS AND INVESTMENTS - (cont'd):

Fiduciary Fund:

The Employee Health Care Benefit Trust Fund investments are made in accordance with the provisions of the State of Michigan Public Employee Retirement System Investment Act, Public Act 314 of 1965, as amended, and are held for the exclusive purpose of providing plan benefits, and defraying reasonable expenses of administration as provided for in the Act.

The Employee Health Care Benefit Trust Fund investments are made through the use of an investment advisor who serves at the leisure of the Trustee as provided by the trust agreement.

Credit Risk - Investments - As of December 31, 2012, the Employee Health Care Benefit Trust Fund has \$110,204 invested exclusively in mutual funds.

Custodial Credit Risk - Investments - is the risk that in the event of the failure of the counterparty, the Road Commission will not be able to recover the value of its investments that are in the possession of another party. The Road Commission's investment policy does not address custodial credit risk.

Interest Rate Risk - Investments - is the risk that the value of investments will decrease as a result of a rise in interest rates. The Road Commission's investment policy does not address interest rate risk.

Concentration of Credit Risk - Investments - is the risk of loss attributed to the magnitude of the Road Commission's investment in a single issuer. The Road Commission's investment policy does not address concentration of credit risk.

NOTE 5 - INVENTORIES:

The inventory balance of \$833,616 at December 31, 2012 consisted of \$582,741 of road materials and \$250,875 of equipment parts and materials.

NOTE 6 - FEDERAL AWARDS:

It is required by the Michigan Department of Transportation ("MDOT") that Road Commissions report total federal awards for Highway Research, Planning and Construction pertaining to their County. However, only the federal awards applicable to force account expenditures are required to be audited for compliance under the Single Audit Act through Road Commission procurement. The reason for this requirement is that the Road Commission is required to have accounting and administrative control over the force account portion while the balance is administered by MDOT.

During the year ended December 31, 2012, the Road Commission had less than \$500,000 of force account expenditures applicable to federal awards. As a result, an audit for compliance under the Single Audit Act has not been performed.

CHEBOYGAN COUNTY ROAD COMMISSION
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NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

NOTE 7 - CAPITAL ASSETS:

Capital assets activity for the current year was as follows:

| | Balance January 1, 2012 | Additions | Removals/ Deletions | Balance December 31, 2012 |
|--|-------------------------------|---------------------|------------------------|---------------------------------|
| Capital Assets, not being depreciated - | | | | |
| Land | \$ 259,255 | \$ - | \$ - | \$ 259,255 |
| Land Improvements | 10,208,126 | 164,870 | - | 10,372,996 |
| Right-of-Ways | 87,308 | - | - | 87,308 |
| Construction in Progress | <u>373,174</u> | <u>1,251,190</u> | <u>1,624,364</u> | <u>-</u> |
| Total Capital Assets, not being depreciated | <u>10,927,863</u> | <u>1,416,060</u> | <u>1,624,364</u> | <u>10,719,559</u> |
| Capital Assets, being depreciated - | | | | |
| Buildings and improvements | 4,004,327 | - | - | 4,004,327 |
| Road Equipment | 7,573,119 | 151,820 | 233,501 | 7,491,438 |
| Shop Equipment | 243,488 | - | 124 | 243,464 |
| Office Equipment | 88,821 | 15,207 | 757 | 103,271 |
| Engineering Equipment | 59,605 | - | - | 59,605 |
| Yard and Storage | 293,557 | - | 1,600 | 291,957 |
| Infrastructure - | | | | |
| Roads | 15,964,788 | 384,997 | 758,462 | 15,591,323 |
| Bridges | 7,837,373 | 1,663,810 | - | 9,501,183 |
| Depletable Assets - | | | | |
| Gravel Pits | <u>27,085</u> | <u>-</u> | <u>-</u> | <u>27,085</u> |
| | <u>36,092,163</u> | <u>2,215,834</u> | <u>994,444</u> | <u>37,313,553</u> |
| Less – accumulated depreciation for - | | | | |
| Buildings | 1,745,301 | 176,522 | - | 1,921,823 |
| Road Equipment | 7,389,190 | 102,732 | 233,298 | 7,258,624 |
| Shop Equipment | 196,282 | 16,058 | 122 | 212,218 |
| Office Equipment | 82,076 | 3,820 | 757 | 85,139 |
| Engineering Equipment | 57,907 | 558 | - | 58,465 |
| Yard and Storage | 181,381 | 22,220 | 760 | 202,841 |
| Infrastructure - | | | | |
| Roads | 6,904,718 | 798,067 | 758,462 | 6,944,323 |
| Bridges | 2,359,006 | 194,805 | - | 2,553,811 |
| Depletable Assets | <u>15,332</u> | <u>-</u> | <u>-</u> | <u>15,332</u> |
| | <u>18,931,193</u> | <u>1,314,782</u> | <u>993,399</u> | <u>19,252,576</u> |
| Total Capital Assets, being depreciated, net | <u>17,160,970</u> | <u>901,052</u> | <u>1,045</u> | <u>18,060,977</u> |
| Governmental activities capital assets, net | <u>\$ 28,088,833</u> | <u>\$ 2,317,112</u> | <u>\$ 1,625,409</u> | <u>\$ 28,780,536</u> |

Total depreciation for the year ended December 31, 2012 was \$1,314,782.

CHEBOYGAN COUNTY ROAD COMMISSION
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NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

NOTE 8 - LETTER OF CREDIT:

The Road Commission has a letter of credit as a surety bond issued to the Michigan Department of Natural Resources for \$10,000. The next maturity date is set for April 4, 2014 with interest at an interest rate of Wall Street Prime Rate plus 4.0%. As of December 31, 2012, there have been no claims on the letter of credit.

NOTE 9 - LONG-TERM LIABILITIES:

The following is a summary of the changes in long-term liabilities of the Road Commission for the year ended December 31, 2012:

| | Balance Jan. 1, 2012 | Additions | Deletions | Balance Dec. 31, 2012 | Due Within One Year |
|--------------------------------------|----------------------------|-------------------|-------------------|-----------------------------|------------------------|
| 2004 MTF Bond | \$ 2,470,000 | \$ - | \$ 95,000 | \$ 2,375,000 | \$ 100,000 |
| Accrued Vacation and Sick | 423,872 | - | 27,569 | 396,303 | 102,266 |
| Net Other Postemployment Benefits | <u>999,623</u> | <u>156,183</u> | <u>-</u> | <u>1,155,806</u> | <u>-</u> |
| | <u>\$ 3,893,495</u> | <u>\$ 156,183</u> | <u>\$ 122,569</u> | <u>\$ 3,927,109</u> | <u>\$ 202,266</u> |

Significant details regarding outstanding long-term liabilities are presented below:

2004 MTF Bonds -

The County of Cheboygan, Michigan issued \$3,060,000 of Michigan Transportation Fund Bonds, Series 2004, dated May 1, 2004, pursuant to the provision of Act 51, Public Acts of Michigan of 1951, as amended. The Bonds are issued in anticipation of and are payable from monies derived from state collected taxes returned to the Road Commission from the Michigan Transportation Fund for highway construction, reconstruction, and work incidental thereto pursuant to Act 51.

Principal on the bonds is due on February 1 through 2029 with interest due semi-annually at interest rates ranging from 3.85% to 4.75%.

The annual requirements to amortize the bond liability outstanding at December 31, 2012 are as follows:

| | Principal | Interest | Total |
|-----------|---------------------|---------------------|---------------------|
| 2013 | \$ 100,000 | \$ 103,150 | \$ 203,150 |
| 2014 | 105,000 | 99,204 | 204,204 |
| 2015 | 105,000 | 95,108 | 200,108 |
| 2016 | 110,000 | 90,835 | 200,835 |
| 2017 | 115,000 | 86,277 | 201,277 |
| 2018-2022 | 650,000 | 352,011 | 1,002,011 |
| 2023-2027 | 810,000 | 188,389 | 998,389 |
| 2028-2029 | <u>380,000</u> | <u>18,289</u> | <u>398,289</u> |
| | <u>\$ 2,375,000</u> | <u>\$ 1,033,263</u> | <u>\$ 3,408,263</u> |

CHEBOYGAN COUNTY ROAD COMMISSION
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NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

NOTE 9 - LONG-TERM LIABILITIES - (cont'd):

Accrued Sick and Vacation -

The accrued sick and vacation represents vested sick and vacation benefits due to Road Commission employees upon termination of employment with the Road Commission. The balance at December 31, 2012, is \$380,871 for sick, and \$15,432 for vacation. All amounts vested have been accrued on the government-wide statements.

Other Postemployment Benefits -

In addition to pension benefits, the Road Commission provides postemployment health care benefits to eligible retirees and their families, as described in Note 11.

NOTE 10 - EMPLOYEE PENSION PLAN:

Plan Description -

The Road Commission participates in the Michigan Municipal Employees Retirement System ("MERS"); an agent multiple employer state-wide, public employee defined benefit pension plan created under Public Act 135 of 1945, and now operates under Public Act 220 of 1996, and the MERS Plan Document as revised. MERS was established to provide retirement, survivor and disability benefits on a voluntary basis to the State of Michigan's local government employees. Act No. 427 of the Public Acts of 1984, as amended, establishes and amends the benefit provisions of the participants in MERS. The Municipal Employees Retirement System of Michigan issues a publicly available financial report that includes financial statements and required supplementary information for MERS. That report may be obtained by writing to the Municipal Employees Retirement System of Michigan, 1134 Municipal Way, Lansing, Michigan 48917 or by calling (800) 767-6377.

Funding Policy -

The plan adopted by the Board of County Road Commissioners requires no employee contribution. The Road Commission is required to contribute at an actuarially determined rate; the weighted average rate for 2012 was 28.14% for general employees and 46.75% for salaried employees. The contribution requirements of plan members and the Road Commission are established and may be amended by the Road Commission, depending on the MERS contribution program adopted by the Road Commission.

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NOTES TO FINANCIAL STATEMENTS
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NOTE 10 - EMPLOYEE PENSION PLAN - (cont'd):

Annual Pension Costs -

For the year ended December 31, 2012, the Road Commission's annual pension cost of \$542,596 for MERS was equal to the Road Commission's required and actual contributions. The required contribution was determined as part of the December 31, 2010 actuarial valuation using the entry age actuarial cost method. The actuarial assumptions include (a) a rate of return on the investment of present and future assets of 8% per year compounded annually, (b) projected salary increases of 4.5% per year compounded annually, attributable to inflation, (c) additional projected salary increases ranging from 0% to 8.40% per year, depending on age, attributable to seniority/merit, and (d) the assumption that benefits will increase 2.5% per year (annually) after retirement, for persons under Benefit E-1 or E-2. The actuarial value of MERS assets was determined using techniques on a basis of evaluation method that assumes the funds earn the expected rate of return (8%) and includes as an adjustment to reflect market value. The standard amortization period to fund the unfunded liability is 28 years for positive unfunded liabilities in the 2010 valuation. This period will be reduced by one year in each of the next eight annual valuations. Beginning with the 2019 valuation the 20-year period will be reestablished with each annual valuation. The standard amortization period for negative unfunded liabilities is 10 years, with the 10-year period reestablished with each annual actuarial valuation. The level percentage of payroll is used to amortize the unfunded actuarial accrued liability.

Three-Year Trend Information

Schedule of Employer Contributions -

| <u>Fiscal Year Ending December 31,</u> | <u>Annual Pension Costs (APC)</u> | <u>Percentage of APC Contribution</u> | <u>Net Pension Obligation</u> |
|--|---------------------------------------|---|-----------------------------------|
| 2010 | \$ 481,864 | 100 % | \$ - |
| 2011 | 564,963 | 100 | - |
| 2012 | 542,596 | 100 | - |

Schedule of Funding Progress -

| <u>Actuarial Valuation Date</u> | <u>Actuarial Value of Assets (a)</u> | <u>Actuarial Accrued Liability (AAL) Entry Age (b)</u> | <u>Unfunded (Overfunded) Accrued Liability (UAAL) (b-a)</u> | <u>Funded Ratio (AAL) (a/b)</u> | <u>Covered Payroll (c)</u> | <u>UAAL as a % of Covered Payroll [(b-a)/c]</u> |
|---|--|--|---|---|------------------------------------|---|
| 2009 | \$ 9,820,653 | \$ 16,599,420 | \$ 6,778,767 | 59 % | \$ 1,861,017 | 364 % |
| 2010 | 9,795,044 | 16,590,612 | 6,795,568 | 59 | 1,688,622 | 402 |
| 2011 | 9,829,050 | 17,245,637 | 7,416,587 | 57 | 1,648,619 | 450 |

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NOTES TO FINANCIAL STATEMENTS
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NOTE 11 - OTHER POSTEMPLOYMENT BENEFITS:

Plan Description -

In addition to the pension benefits described in Note 10, the Road Commission provides postemployment benefits through a single-employer defined benefit healthcare plan (the "Retiree Health Plan") to eligible employees who retire from the Road Commission on or after attaining retirement age with at least ten years of service. Benefits provided by the plan consist of healthcare, dental, and prescription drug coverage. Benefit provisions are established through negotiations between the Road Commission's management and Board of Commissioners and the employees' unions.

The retiree health plan does not issue a publically available financial report.

Funding Policy -

The Road Commission recognizes the cost of providing these benefits on a pay-as-you-go method for current retirees. The plan requires no member contributions for Road Commission employees. The Road Commission can periodically make contributions to an irrevocable trust to provide advance funds for these benefits which are counted towards the ARC contribution.

Annual Benefit Costs -

During the year ended December 31, 2012, employer contributions of \$566,914, which included \$50,000 contributed to the OPEB trust fund, were made by the Road Commission. The alternative measurement method dated December 31, 2011 determined an annual contribution of \$716,675.

The methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. The benefit costs were developed using the entry age cost method. The assumptions included (a) 7.0% investment rate of return, (b) 4.8% discount rate, (c) projected health care premium increases of 6.8% to 7.0% per year, (d) life expectancies for males and females of 77 and 81 years, respectively, (e) assumed retirement age of 58, or at the first subsequent year in which the member would qualify for benefits. The plan unfunded actuarial accrued liability is being amortized by level percent of payroll contributions over 30 years on an open period.

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NOTES TO FINANCIAL STATEMENTS
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NOTE 11 - OTHER POSTEMPLOYMENT BENEFITS - (cont'd):

Annual OPEB Cost and Net OPEB Obligation -

The Road Commission's annual other postemployment benefit (OPEB) cost is calculated based on the annual required contribution of the employer (ARC), an amount calculated in accordance with the alternative measurement method permitted by GASB Statement 45 for employers in plans with fewer than one hundred total plan members. The ARC represents the level of funding necessary to cover the normal cost each year and the amortization of any unfunded actuarial liabilities (or funding excess) amortized over a period not to exceed thirty years. The Road Commission's annual OPEB cost for the year, the amount actually contributed, and changes in the net OPEB obligation are as follows:

| | |
|--|---------------------|
| Annual required contribution | \$ 716,675 |
| Interest on net OPEB obligation | 69,974 |
| Adjustment to annual required contribution | (63,552) |
| Annual OPEB cost (expense) | 723,097 |
| Contributions made | (566,914) |
| Increase in net OPEB obligation | 156,183 |
| Net OPEB obligation - beginning of year | 999,623 |
| Net OPEB obligation - end of year | <u>\$ 1,155,806</u> |

Schedule of Employer Contributions -

| Year Ended | Annual OPEB Cost | Percentage Contributed | Net OPEB Obligation |
|-------------------|---------------------|---------------------------|------------------------|
| December 31, 2010 | \$ 757,285 | 62.09 % | \$ 870,960 |
| December 31, 2011 | 722,270 | 82.19 | 999,623 |
| December 31, 2012 | 723,097 | 78.40 | 1,155,806 |

Funded Status and Funding Progress -

The projection of future benefit payments for an ongoing plan involves estimates for the value of reported amounts and assumptions about the probability or occurrence of events far into the future. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

The Schedule of Funding Progress is as follows:

| Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) Entry Age (b) | Unfunded (Overfunded) | Funded Ratio (AAL) (a/b) | Covered Payroll (c) | UAAL as a % of Covered Payroll (b-a)/c |
|--------------------------------|--|---|---|--------------------------------|---------------------------|---|
| | | | Accrued Liability (UAAL) (b-a) | | | |
| 2008 | \$ - | \$ 8,259,076 | \$ 8,259,076 | 0 % | \$ 1,876,594 | 440 % |
| 2011 | 51,667 | 7,968,733 | 7,917,066 | 0.65 | 1,688,622 | 469 |

CHEBOYGAN COUNTY ROAD COMMISSION
A Component Unit of Cheboygan County, Michigan

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

NOTE 12 - ADVANCES:

Advances of \$174,104 at December 31, 2012, were provided by the State of Michigan for working capital of \$131,875 and equipment purchases of \$42,229 under a road maintenance contract the Road Commission has with MDOT.

Both advances are adjusted annually by the State and must be repaid if the maintenance contract is cancelled.

NOTE 13 - SUMMARY OF DISCLOSURE OF SIGNIFICANT CONTINGENCIES:

In the normal course of its operations, the Road Commission often becomes a party to various claims and lawsuits. In the opinion of the Road Commission's legal counsel, if any of these claims should result in an unfavorable resolution to the Road Commission, the Road Commission's liability would be limited to its deductible under insurance policies. The insurer would pay the losses, and there should be no material effect on the financial position of the Road Commission.

As part of its trunkline maintenance agreement with the State of Michigan, the Road Commission's costs charged to the State are subject to audit. The amounts, if any, which may have to be paid back to the State cannot be determined at this time, although the Road Commission expects such amounts, if any, to be immaterial.

NOTE 14 - RISK MANAGEMENT:

The Road Commission is a member of the Michigan County Road Commission Self-Insurance Pool (the "Pool") established pursuant to the laws of the State of Michigan, which authorize contracts between municipal corporations (inter-local agreements) to form group self-insurance pools, and to prescribe conditions to the performance of these contracts.

The Pool was established for the purpose of making a self-insurance pooling program available for Michigan County Road Commissions which includes, but is not limited to, general liability coverages, auto liability coverages, property insurance coverages, stop loss insurance protection, claims administration, and risk management and loss control services pursuant to Michigan Public Act 138 of 1982.

The Road Commission pays an annual premium to the Pool for property (buildings and contents) coverage, automobile and equipment liability, errors or omissions liability and bodily injury, property damage and personal injury liability. The agreement for the formation of the Pool provides that the Pool will be self-sustaining through member premiums and will purchase both specific and aggregate stop-loss insurance to the limits determined necessary by the Pool Board.

The Road Commission is also a member of the County Road Association Self-Insurance Fund (the "Fund") for workers' compensation self-insurance. The Fund is a municipal self-insurance entity operating within the laws of the State of Michigan. The Fund has entered into reinsurance agreements providing for loss coverage in excess of amounts to be retained by the Fund.

CHEBOYGAN COUNTY ROAD COMMISSION
A Component Unit of Cheboygan County, Michigan

NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2012

NOTE 14 - RISK MANAGEMENT - (cont'd):

The Road Commission is self-insured for health care benefits with the administrative services of the program being performed by a health insurance provider. The Road Commission makes monthly payments, based on estimated claims and a stop-loss provision, which are adjusted quarterly. The Road Commission pays claims up to \$50,000 per contract per contract year. Stop-loss insurance has been purchased to insure the Road Commission against losses in excess of these limits. Based on past history, the Road Commission has estimated the accrued health care claims, including an estimate for claims incurred but not reported (IBNR), of \$40,000 at December 31, 2012, which is recorded as current liabilities in the fund financial statements. Changes in the balance of claims liability are as follows:

| | <u>2012</u> | <u>2011</u> |
|------------------------------------|-------------------|-------------------|
| Unpaid claims, beginning of year | \$ 40,000 | \$ 40,000 |
| Incurred claims (including IBNR's) | 628,090 | 758,340 |
| Claims Paid | <u>(628,090)</u> | <u>(758,340)</u> |
| Unpaid claims, end of year | 40,000 | 40,000 |
| Less current portion | <u>40,000</u> | <u>40,000</u> |
| Long-Term Liabilities | <u>\$ -</u> | <u>\$ -</u> |

REQUIRED SUPPLEMENTARY INFORMATION

CHEBOYGAN COUNTY ROAD COMMISSION
A Component Unit of Cheboygan County, Michigan

**SCHEDULE OF GENERAL FUND REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE
BUDGET AND ACTUAL
FOR THE YEAR ENDED DECEMBER 31, 2012**

| | Original Budget | Final Budget | Actual | Variance with Final Budget Positive (Negative) |
|------------------------------------|---------------------|---------------------|---------------------|---|
| Revenues: | | | | |
| Permits | \$ 25,000 | \$ 28,500 | \$ 29,005 | \$ 505 |
| Intergovernmental - | | | | |
| Federal sources | 50,400 | 31,220 | 28,079 | (3,141) |
| State sources | 4,960,442 | 4,730,198 | 4,800,685 | 70,487 |
| Local sources | 394,712 | 645,000 | 708,799 | 63,799 |
| Charges for services | 1,509,220 | 1,780,600 | 2,092,971 | 312,371 |
| Interest and rents | 3,200 | 1,600 | 1,722 | 122 |
| Other | 75,000 | 134,000 | 43,844 | (90,156) |
| Total Revenues | <u>7,017,974</u> | <u>7,351,118</u> | <u>7,705,105</u> | <u>353,987</u> |
| Expenditures: | | | | |
| Current - | | | | |
| Primary preservation - | | | | |
| structural improvements | 1,439,000 | 1,274,000 | 1,264,371 | 9,629 |
| Local preservation - | | | | |
| structural improvements | 440,140 | 579,000 | 576,132 | 2,868 |
| Primary maintenance | 1,927,424 | 1,200,000 | 1,058,791 | 141,209 |
| Local maintenance | 1,523,334 | 1,800,000 | 1,705,637 | 94,363 |
| State maintenance | 1,509,220 | 1,669,600 | 1,736,682 | (67,082) |
| Administrative | 370,000 | 431,761 | 396,747 | 35,014 |
| Equipment - net | - | 107,000 | 481,999 | (374,999) |
| Capital Outlay - net | (200,000) | (162,433) | (133,644) | (28,789) |
| Debt Service | 258,856 | 201,856 | 201,856 | - |
| Total Expenditures | <u>7,267,974</u> | <u>7,100,784</u> | <u>7,288,571</u> | <u>(187,787)</u> |
| Revenues over (under) expenditures | (250,000) | 250,334 | 416,534 | 166,200 |
| Other Financing Sources: | | | | |
| Loan Proceeds | <u>250,000</u> | <u>-</u> | <u>-</u> | <u>-</u> |
| Net change in fund balance | - | 250,334 | 416,534 | 166,200 |
| Fund Balance at January 1, 2012 | <u>2,619,214</u> | <u>2,619,214</u> | <u>2,619,214</u> | <u>-</u> |
| Fund Balance at December 31, 2012 | <u>\$ 2,619,214</u> | <u>\$ 2,869,548</u> | <u>\$ 3,035,748</u> | <u>\$ 166,200</u> |

SUPPLEMENTARY INFORMATION

CHEBOYGAN COUNTY ROAD COMMISSION
A Component Unit of Cheboygan County

DETAIL SCHEDULE OF REVENUES
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2012

Revenues:

| | |
|--|----------------------------|
| Permits | \$ 29,005 |
| Federal Sources - | |
| Surface Transportation Program (STP) | - |
| Bridge | 4,550 |
| Other | 23,529 |
| | <u>28,079</u> |
| State Sources - | |
| Motor Vehicle Highway Funds - Act 51 - | |
| Engineering | 10,000 |
| Primary Allocation roads | 1,815,486 |
| Local Allocation roads | 1,630,548 |
| Snow Removal | 130,457 |
| Critical Bridge | 1,091,866 |
| Forest Road Money | 119,636 |
| Other | 2,692 |
| | <u>4,800,685</u> |
| Local Sources - | |
| Township contributions | 653,761 |
| Other contributions | 55,038 |
| | <u>708,799</u> |
| Charges for Services - | |
| Trunkline maintenance | 1,938,539 |
| Trunkline nonmaintenance | 120,205 |
| Salvage and other | 34,227 |
| | <u>2,092,971</u> |
| Interest and Rents | <u>1,722</u> |
| Other - | |
| Sundry refunds | 10 |
| Proceeds/gain on equipment disposal | 43,834 |
| | <u>43,844</u> |
| Total Revenues | <u><u>\$ 7,705,105</u></u> |

CHEBOYGAN COUNTY ROAD COMMISSION
A Component Unit of Cheboygan County

DETAIL SCHEDULE OF EXPENDITURES
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2012

Expenditures:

| | |
|---|----------------------------|
| Preservation/ structural improvements - | |
| Primary roads and structures | \$ 1,264,371 |
| Local roads and structures | 576,132 |
| | <u>1,840,503</u> |
| Maintenance - | |
| Primary roads and structures, | |
| winter maintenance and traffic control | 1,058,791 |
| Local roads and structures, | |
| winter maintenance, and traffic control | 1,705,637 |
| | <u>2,764,428</u> |
| State Maintenance - | |
| Trunkline maintenance | 1,616,477 |
| Trunkline nonmaintenance | 120,205 |
| | <u>1,736,682</u> |
| Equipment - | |
| Direct | 1,017,613 |
| Indirect | 769,365 |
| Operating | 467,422 |
| Less - equipment rental | (1,772,401) |
| | <u>481,999</u> |
| Administrative - | |
| Administration | 574,361 |
| Less - | |
| State trunkline overhead | (170,470) |
| Purchase discounts and other | (7,144) |
| | <u>396,747</u> |
| Capital Outlay - | |
| Equipment | 167,027 |
| Less - | |
| Depreciation | (299,626) |
| Equipment retirements | (1,045) |
| | <u>(133,644)</u> |
| Debt Service - | |
| Principal retirement | 95,000 |
| Interest | 106,856 |
| | <u>201,856</u> |
| Total Expenditures | <u><u>\$ 7,288,571</u></u> |

CHEBOYGAN COUNTY ROAD COMMISSION**A Component Unit of Cheboygan County****SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES****BY FUND BALANCE SUB-ACCOUNTS****GENERAL FUND****FOR THE YEAR ENDED DECEMBER 31, 2012**

| | <u>Primary</u> | <u>Local</u> | <u>County</u> | <u>Total</u> |
|---|-------------------|-------------------|---------------------|---------------------|
| Revenues: | | | | |
| Permits | \$ - | \$ 300 | \$ 28,705 | \$ 29,005 |
| Intergovernmental - | | | | |
| Federal Sources | - | 4,550 | 23,529 | 28,079 |
| State Sources | 3,085,257 | 1,712,736 | 2,692 | 4,800,685 |
| Local Sources | 16,157 | 657,705 | 34,937 | 708,799 |
| Charges for services | - | - | 2,092,971 | 2,092,971 |
| Interest | 320 | 305 | 1,097 | 1,722 |
| Other | - | - | 43,844 | 43,844 |
| Total Revenues | <u>3,101,734</u> | <u>2,375,596</u> | <u>2,227,775</u> | <u>7,705,105</u> |
| Expenditures: | | | | |
| Preservation/ structural improvements | 1,264,371 | 576,132 | - | 1,840,503 |
| Maintenance | 1,058,791 | 1,705,637 | - | 2,764,428 |
| State maintenance | - | - | 1,736,682 | 1,736,682 |
| Administrative - net | 200,157 | 196,590 | - | 396,747 |
| Equipment - net | 105,554 | 247,754 | 128,691 | 481,999 |
| Capital outlay - net | - | - | (133,644) | (133,644) |
| Debt Service - | | | | |
| Principal | - | - | 95,000 | 95,000 |
| Interest and issuance costs | - | - | 106,856 | 106,856 |
| Total Expenditures | <u>2,628,873</u> | <u>2,726,113</u> | <u>1,933,585</u> | <u>7,288,571</u> |
| Revenues over (under) expenditures before optional transfers | 472,861 | (350,517) | 294,190 | 416,534 |
| Optional transfers | <u>(360,000)</u> | <u>360,000</u> | <u>-</u> | <u>-</u> |
| Net Changes in Fund Balance | 112,861 | 9,483 | 294,190 | 416,534 |
| Fund Balance at January 1, 2012 | <u>488,093</u> | <u>464,611</u> | <u>1,666,510</u> | <u>2,619,214</u> |
| Fund Balance at December 31, 2012 | <u>\$ 600,954</u> | <u>\$ 474,094</u> | <u>\$ 1,960,700</u> | <u>\$ 3,035,748</u> |

**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL
OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER
MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH *GOVERNMENTAL AUDITING STANDARDS***

To the Board of County Road Commissioners
of Cheboygan County
Indian River, Michigan

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the General Fund and the Employee Health Care Benefit Trust Fund of the Cheboygan County Road Commission (the "Road Commission"), as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the Road Commission's basic financial statements, and have issued our report thereon dated April 15, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Road Commission's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Road Commission's internal control. Accordingly, we do not express an opinion on the effectiveness of the Road Commission's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. Material weaknesses may exist that have not been identified. However, as discussed below, we identified a deficiency in internal control over financial reporting, which is referenced as 12-01, that we consider to be a significant deficiency in internal control over financial reporting.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Road Commission's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Stewart Beaumais & Whipple, PC.

Certified Public Accountants

April 15, 2013

CHEBOYGAN COUNTY ROAD COMMISSION

SCHEDULE OF FINDINGS AND RESPONSES DECEMBER 31, 2012

12-01: Preparation of Financial Statements in Accordance with Generally Accepted Accounting Principles (GAAP).

The Road Commission prepares various financial information to assess operations and the financial condition of the Road Commission, including the completion of the MDOT Act 51 Report at year end. However, that information is not required to be a complete presentation in accordance with generally accepted accounting principles. As a result, the Road Commission relies on the audit firm to assist in preparing the annual financial report in accordance with generally accepted accounting principles.

The Road Commission has individuals on staff to review and determine that the financial report is accurate, however, has not elected to review and determine that the financial report is a complete presentation in accordance with generally accepted accounting principles. As a result, the Road Commission, under Statement on Auditing Standards No. 115, is considered to have a significant control deficiency, since reporting errors or omissions could occur in the presentation of the annual financial report that would be departures from generally accepted accounting principles and the Road Commission may not be in a position to detect the errors or omissions.

Client's Response: The Road Commission has evaluated the cost versus the benefit of expanding internal controls over the preparation of the annual financial statements to include reporting in accordance with GAAP, and has determined that it is in the best interest of the Road Commission to outsource this responsibility to the external auditors. The Road Commission will continue to carefully review the draft financial statements and notes prior to approving and accepting responsibility for their content and presentation.

AUDIT COMMUNICATION LETTER

April 15, 2013

To the County Road Commissioners of
Cheboygan County Road Commission
Indian River, Michigan

We have audited the financial statements of the governmental activities, the General Fund, and the Employee Health Benefit Trust Fund of the Cheboygan County Road Commission (the "Road Commission") for the year ended December 31, 2012, which collectively comprise the Road Commission's basic financial statements, and have issued our report thereon dated April 15, 2013. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated September 13, 2012.

Significant Items

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the Road Commission are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2012. We noted no transactions entered into by the governmental unit during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

Accounting estimates are an integral part of the basic financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

As part of the implementation of GASB 34, the Road Commission was required to record infrastructure as a capital asset. As a result, the original costs of roads, bridges, traffic signals, land improvements and right-of-ways had to be determined. Because the supporting data for original cost was not always available, estimates were required to be made based on available data. We evaluated the key factors and assumptions used to develop the cost estimates for infrastructure and determined that it is reasonable in relation to the financial statements taken as a whole.

Management's estimate of depreciation is based on Michigan Department of Transportation guidelines. We evaluated the key factors and assumptions used to develop the depreciation estimate in determining that it is reasonable in relation to the financial statements taken as a whole.

Management's estimate of the annual other postemployment benefits cost is based on a calculation in accordance with the alternative method permitted by GASB Statement 45, which was performed by a contracted agency. We evaluated the methodology of the health care cost within the acceptable parameters of the GASB Statement 45 and determined that it is reasonable in relation to the financial statements taken as a whole.

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosure affecting the financial statements was:

The disclosure of Other Postemployment Benefits in Note 11 to the financial statements describes the benefits provided to retirees other than pensions. This disclosure is particularly sensitive to financial statement users because of the dollar amount of the Net OPEB obligation at year-end and the future impact this number will have if the annual required contribution is also not met in future years.

Difficulties Encountered in Performing the Audit

We encountered no difficulties in dealing with management in performing and completing our audit.

Recorded and Unrecorded Adjustments

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. The attached schedule summarizes unrecorded adjustments to the financial statements. Management has determined that the effect is immaterial to the financial statements taken as a whole, with which we concur.

Assistance with GASB 34 Presentation

As a result of our assistance with GASB 34 presentation, we proposed several entries to the December 31, 2012 account balances to reflect the difference between the General Fund and the Government-wide financial statements. The entries and the resulting presentation were reviewed and accepted by management. The entries are described in Note 2 to the financial statements.

Statements on Auditing Standard No. 115

Statement on Auditing Standards No. 115 "Communicating Internal Control Related Matters Identified in an Audit" specifies that if an entity does not have an individual(s) on staff that can draft or review the financial statements to assure that they are accurate and reported in accordance with generally accepted accounting principles, then the entity has at a minimum a significant deficiency in internal control over reporting.

If a governmental organization relies on our firm to present the financial statements in accordance with generally accepted accounting principles, we are required to report that there is a significant deficiency in internal control. We, again, fulfilled this responsibility in your internal control letter for the year ended December 31, 2012.

A substantial portion of our clients are receiving this comment, and per discussions with other CPA firms, a substantial number of their clients are also receiving this comment. This is the result of it being the practice in the past to rely on the auditor since the annual financial report is prepared once a year and we stay current on generally accepted accounting principles. We recommend that the Road Commission evaluate the cost versus the benefit of expanding internal control over financial reporting to include presentation under GAAP.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated April 15, 2013.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the Road Commission's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Finding or Issues

In the Independent Auditor's Report on Internal Control Over Financial Reporting and On Compliance and Other Matters, we noted a deficiency in internal control over financial reporting that we consider to be a significant deficiency as previously described in this letter.

In addition to the Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance, we noted a certain item that, although not considered a significant deficiency, could improve controls, the operational efficiency and/or compliance with laws and regulations. This item is discussed in Attachment A.

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the governmental unit's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

This information is intended solely for the use of the Board of County Road Commissioners, and management, and is not intended to be and should not be used by anyone other than these specified parties.

We appreciate the opportunity to be of service to the Board of County Road Commissioners of Cheboygan County.

Stewart Beaumais & Whipple, PC.
Certified Public Accountants

Attachment A

The following is an item that we discussed with management that is not considered a significant deficiency; however, is an item that could improve controls, reporting and/or compliance with laws and regulations:

Employment status of employees should be reviewed.

During our evaluation of payroll, we noted an employee whose employment agreement states the individual to be an hourly employee currently not turning in documentation of time worked. All hourly employees should fill out time cards or some form of documentation of time worked to protect the Road Commission from potential liability should the employee make a claim that additional hours have been worked.